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C O N F I D E N T I A L SECTION 01 OF 05 CARACAS 000988

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ENERGY FOR CDAY AND ALOCKWOOD
NSC FOR DTOMLINSON AND JSHRIER

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TAGS: EPET ENRG EINV ECON VE
SUBJECT: VENEZUELAN PRODUCTION AND OPERATING TRENDS

REF: A. 2006 CARACAS 1363
¶B. 2006 CARACAS 1238
¶C. 2006 CARACAS 2297

Classified By: Economic Counselor Andrew N. Bowen for Reason 1.4 (D)

¶1. (C) SUMMARY: Private sector contacts place overall Venezuelan production at 2.1 to 2.3 million barrels a day, down from previous estimates of 2.4 to 2.6. The BRV has lifted OPEC production cuts on the four Faja strategic associations. PDVSA has been unable to find additional drilling rigs despite offering very generous terms. In addition, PDVSA has begun offering five year tenders in the East and West but has withdrawn some of the tenders due to shoddy drafting. It appears that the BRV is still serious about forming a national service company. PDVSA's administrative capabilities are still in shambles and continue to decline. END SUMMARY

PRODUCTION

¶2. (C) During SIMO analyst's May 1-12 visit to Venezuela, multiple private sector contacts placed total Venezuelan production between 2.1 to 2.3 million barrels a day with one contact claiming 1.9 million barrels per day. Private sector contacts over the past year had fixed overall production at 2.4 to 2.6 million barrels. PDVSA continues to claim production figures of over 3 million barrels per day. Andres Duarte (strictly protect throughout), a prominent businessman and member of the Petroleum Chamber board, told Petroleum Attache (Petatt) and the analyst on May 10 that term contracts for refined products were down substantially. Duarte stated naphtha and kerosene shipments were non-existent. He added that the Isla refinery in Caribbean was supplying the Venezuelan local market with products.

¶3. (C) Chevron Latin America President Ali Moshiri (strictly protect throughout) told Petatt on May 17 that the BRV lifted

OPEC production cuts on the four Faja strategic associations this week. Moshiri did not believe the lifting of the cuts would have an immediate impact on the overall level of production due to the nature of the association's crude oil. He told Petatt that Chevron would need five months to restore production, assuming that it controlled the process and focused on lifting production. Given the fact that PDVSA now controls operations, Moshiri said he was not sure they would be able to completely restore production at Hamaca.

¶4. (C) PDVSA's production woes stem in part from a lack of drilling rigs. Oil analysts Diego Gonzalez and Ramon Espinasa (strictly protect both throughout) have estimated that PDVSA would need between 100 to 120 drilling rigs and approximately 200 workover rigs in order to achieve production of over 3 million barrels per day. Both analysts base their estimate on the fact that PDVSA had 111 drilling rigs operating in February 1998 with a production level of 3.329 million barrels per day. The Baker Hughes rig count for Venezuela for April 2007 was 68 oil rigs and 11 gas rigs.

¶5. (C) According to multiple contacts, PDVSA is desperately seeking additional rigs for Venezuela. More than one contact told Petatt and analyst that PDVSA sent a delegation to Houston in late April seeking a large number of rigs. The delegation was basically given a blank check to secure the rigs, but was unable to reach agreement on a single rig.

¶6. (C) Service company contacts stated no one is willing to bring new rigs to Venezuela due to fears that they would be unable to remove the rigs. These fears appear to be fully justified based on recent actions by PDVSA. Energy Minister

Rafael Ramirez announced that PDVSA had "nationalized" 18 rigs on May 13 and stated more than 300 workers would become PDVSA employees. During a May 2 meeting with Petatt and analyst, Maersk executives (strictly protect throughout) complained that derrickmen and drillers have been in short supply in Venezuela. As a result, it makes a great deal of sense for PDVSA to add these types of employees to its rolls. Baker Hughes Country Manager Mauricio Moreno (strictly protect throughout) told Petatt on May 17 that PDVSA had revoked management contracts for PDVSA-owned rigs and then forcibly migrated the private sector workers to its employment rolls.

¶7. (C) Maersk executives also stated that a contract with PDVSA for one of their rigs on Lake Maracaibo had recently expired. The company reached a rental agreement with one of the PDVSA-controlled joint ventures for the rig but PDVSA vetoed the contract on the grounds that the rig was part of its long range production plans. Maersk owns 10 rigs that operate on Lake Maracaibo and managed two rigs for PDVSA. We believe that the two rigs were part of the 18 that were "nationalized." Both Duarte and Moreno stated Maersk is trying to sell all of its rigs to a Venezuelan consortium. Duarte stated Maersk was selling the rigs "as is where is" for USD 200 million. He stated the deal fell through because the consortium was unable to come up with the asking price. Moreno stated he had heard the deal was not going forward but had not heard the reason why.

¶8. (C) Ramirez also stated in the interview that PDVSA would finally receive rigs under the much-ballyhooed but long-delayed Chinese rig deal (Reftel A). According to Ramirez, PDVSA will receive its first Chinese-manufactured rig in November and then receive an additional 12 rigs. The rigs will arrive one at a time on a monthly basis. Ramirez also stated 70 Venezuelans were studying rig operations in China and that they would man the new rigs. Maersk executives also stated that PDVSA has started a new project called Premium to rehabilitate old, stacked rigs. The executives stated the old rigs had been cannibalized for parts and were in poor condition. They did not believe PDVSA would gain an appreciable number of workable rigs from the

project.

NEW BIDDING POLICIES

¶9. (C) Halliburton executives (strictly protect throughout) told Petatt and analyst on May 2 that PDVSA has handled bidding issues differently in eastern and western Venezuela. In the West, PDVSA has used the 2005 price list, while in the East, it has used direct assignment. However, PDVSA is now moving toward a system of five year tenders in both the East and West. The maximum time period for contracts in the West used to be two years. Maersk executives stated PDVSA will begin offering five year contracts on July 1. Halliburton executives stated PDVSA currently has 14 tenders out and that the number could rise to 19. They stated PDVSA officials were under a great deal of pressure to put out tenders quickly and the tenders were full of mistakes. Moreno stated he was aware of 12 outstanding tenders but stated PDVSA had to withdraw three of them due to errors in such basic terms as payment.

¶10. (C) BJ Services Country Manager Paul Moss (strictly protect throughout) told Petatt and analyst on May 7 that PDVSA budgets for the tenders are quite extravagant. According to Moss, the budget for cementing is USD 1.3 billion, which he believes is a world record. Maersk executives expressed concerns over the lengths of the tenders. They worried that PDVSA would not properly index

costs over the life of the contracts.

¶11. (C) Multiple service company contacts also stated that PDVSA has begun splitting contracts with a weighted average in favor of the winner. For example, if five companies bid on a contract, PDVSA may award it to three of them. The winner would receive 50%, the second company 30%, and the third 20%. The second and third company would have to match the terms of the winner of the contract.

NATIONAL SERVICE COMPANY

¶12. (C) Local and international service companies also continue to labor under the threat of the formation of a national service company. Andres Pantin (strictly protect throughout), the director of local service company CPVEN, stated on May 7 that PDVSA has an office with seven to nine employees that is dedicated to the formation of a national service company. He stated the company would focus on services such as cementing and mud. He said CPVEN was going to expand its service lines in order to diversify its risk; it is currently focused on well completion services. Pantin also claimed that the BRV warned Halliburton and Schlumberger that they had three years to begin cooperating with the Bolivarian revolution. He did not elaborate on what that meant. Duarte said he also heard that the BRV would form a national service company that would initially focus on well completion services such as cementing. When Petatt raised the issue with Moreno, he stated it made sense for a national service company to focus on completion services since local companies were capable of handling these types of services in an adequate manner. Moreno added the local companies used old technology and could perform relatively unsophisticated jobs.

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MONEY, MONEY, YOU DON'T NEED NO STINKING MONEY
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¶13. (C) Service company executives and oil executives with firms that partner with PDVSA in joint ventures painted a mixed picture on the subject of payments. As for service companies, Halliburton executives stated they were now waiting 35 days for payment, up from 30. Pantin stated PDVSA was 170 days behind in payment, down from 210 days. On the

other hand, Moss stated BJ Services has received all of its payments and does not have any overdue accounts. Baker Hughes executives in separate meetings also complained of payment delays and attempts by PDVSA to increase the Bolivar portion of payments. Halliburton also complained that PDVSA has attempted to increase the Bolivar portion of payments and decrease USD payments.

¶14. (C) Moreno stated Baker Hughes is very concerned that PDVSA will not pay expenses arising form the Corocoro project in a timely manner. Prior to PDVSA assuming operational control on May 1, ConocoPhillips, PDVSA, and ENI paid into a joint account that was used to pay contractors. As operator, ConocoPhillips placed its own funds in the account and was reimbursed by its partners in order to insure that suppliers were paid on time. Moreno stated PDVSA does not appear to be placing any funds in the account. Moreno stated Corocoro's first block of wells are scheduled to go on line. However, Baker Hughes is thinking of canceling the contract it has for equipment for the second block of wells since it is unsure of the status of the contract and PDVSA's ability or willingness to pay. When asked if he saw any patterns in PDVSA's decisions to pay some companies quickly and others slowly, Moreno admitted that he has been unable to detect any rhythm or reason to PDVSA's actions.

¶15. (C) Some service companies appear to have reached the point where they are threatening to pull equipment out of Venezuela if they are not paid in a reasonable period of time. Moss stated Superior Drilling pulled a rig after PDVSA fell behind in payments. The company had to cut the legs off of the rig in order to take it out of Lake Maracaibo. The company had repeatedly told PDVSA that it would not bring the rig back if they took it out of Maracaibo. Weeks after the rig's departure, PDVSA managers were mystified when they were told that the rig would not be coming back to Venezuela. Duarte, who is a shipping agent, stated the Danish owner of a tanker gave PDVSA five days to pay him. PDVSA was three months in arrears. PDVSA managed to pay the owner in the nick of time. Shell Venezuela President Sean Rooney (strictly protect throughout) told Petatt and analyst on May 10 that the joint venture Shell has with PDVSA lost the services of a lift boat when PDVSA failed to make payments in a timely manner. The joint venture still has the ability to drill wells but it will do so in a much less efficient manner due to the loss of the boat.

¶16. (C) One bright spot is that PDVSA appears to have improved its payments somewhat to the joint ventures that were formed from the former Operating Service Agreements. Rooney stated Shell's joint venture is preparing to pay a dividend. Moshiri stated the BRV owes Chevron USD 150 million in dividends for the Petroboscan joint venture. He is hoping to receive payment in June. In addition, local oil analysts reported on May 11 that at least three joint ventures had received payment for oil produced between April 2006 and December 2006. Payment was made in USD, cash net of royalties. The analysts stated other joint ventures were scheduled to be paid over the next two weeks. The analysts believe that payment is still owed on an estimated 300,000 barrels per day of joint venture production from April-December 2006. They estimate the amount owed to be USD 7 billion.

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PDVSA: A CHARMING MIX OF IGNORANCE AND ARROGANCE
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¶17. (C) As reported in Reftels B and C, PDVSA has suffered from an acute case of administrative incompetence for a significant period of time. Unfortunately, the decline in its administrative abilities seems to have accelerated. Contacts in both the East and West reported situations in which they were told by authorities in Caracas that their respective companies were entitled to payments under existing

contracts. When executives approached the regional authorities for payment they were told that they would not be paid under any circumstances since the regional authorities believed payment ran counter to the interests of the Bolivarian revolution. These incidents raise grave concerns about the ability of the Energy Ministry and PDVSA headquarters to control the actions of regional authorities.

¶18. (C) The disintegration of "command and control" also appears to be prevalent within the regions. Halliburton executives stated that the four operating districts in the Western region operate differently. The districts have the same general operating framework but differ on how they handle details. The executives also complained that PDVSA is trying to combine land and off-shore operations in the West, a decision that does not make any sense operationally.

¶19. (C) PDVSA employees in the same units also carry on internecine battles. Moshiri stated PDVSA is riven with intertribal feuds. For example, he noted the president, upstream manager, and downstream manager of Hamaca, all PDVSA employees, can't seem to coordinate any of their actions and squabble constantly.

¶20. (C) The lack of coordination and oversight lead PDVSA to make decisions that do not make commercial sense. For example, John Paul McKee (strictly protect throughout), operations manager for Harvest Vinccler, told Petatt and analyst that Harvest requested the use of a drilling rig that was on stand-by at the Hamaca strategic association. Rather than letting the joint venture, which it controlled, use the rig, PDVSA opted to keep it on stand-by and pay the stand-by fees.

¶21. (C) Bolivarian political correctness in labor issues also creates additional problems. McKee stated his joint venture attempted recently to hire a geophysicist. Venezuelan universities only produced five geophysicists last year. After interviewing all of them, McKee was told by PDVSA that he could not hire any of them because all of them came from families that were politically suspect. PDVSA also blocked McKee's hiring of an engineer from the Petrozuata strategic association. The engineer was told that he would be blacklisted by PDVSA if he changed jobs. McKee's employees were told point blank at the time of their company's migration to a joint venture that they could either sign up with the joint venture or never work with PDVSA or any of its affiliates. It is not clear how many former PDVSA employees have been culled from the joint ventures or the strategic associations. Maersk officials ruefully noted that if their operations were nationalized, 50% of the employees would be let go because they are former, pre-strike PDVSA employees.

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COMMENT: BETTER TO RULE IN HELL THAN SERVE IN HEAVEN
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¶22. (C) We have little doubt that PDVSA's sheer incompetence will lead to further declines in production. When this occurs, the BRV has no one to blame but itself. As the PDVSA appointed president of McKee's strategic association told him: there are no joint ventures, just expropriations. PDVSA has clearly served notice it is not interested in private sector partnerships or assistance. It also appears that senior PDVSA officials are aware of the price this policy carries. Duarte stated he attended a recent barbecue with Energy Vice Minister Mommer's son, who is in the oil business. The younger Mommer stated that Energy Minister Ramirez attended a celebration in an executive's house following the May 1 ceremony marking PDVSA's assumption of operational control in the strategic associations. After drinking too much champagne, Ramirez reportedly stated "If the President knew what was really going on in PDVSA, he'd kick my ass".

BROWNFIELD